IN THE

# Supreme Court of the United States

October Term, 1979

No. 79-878

WESTMORELAND HOSPITAL ASSOCIATION, a non-profit corporation, LATROBE AREA HOSPITAL, a non-profit corporation, THE ALTOONA HOSPITAL, a non-profit corporation, THE HAMOT MEDICAL CENTER OF ERIE, PENNSYLVANIA, a non-profit corporation, MEADVILLE CITY HOSPITAL, a non-profit corporation, SAINT VINCENT HEALTH CENTER, a non-profit corporation, COMMUNITY MENTAL HEALTH CENTER OF BEAVER COUNTY, a non-profit corporation, SOUTH HILLS HEALTH SYSTEM, a non-profit corporation, and HENRY CLAY FRICK COMMUNITY HOSPITAL, a non-profit corporation,

*Plaintiffs-Petitioners,*

v.

BLUE CROSS OF WESTERN PENNSYLVANIA, a non-profit corporation,

*Defendant-Respondent.*

## BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

EDWARD L. SPRINGER
JOSEPH FRIEDMAN
STEPHEN F. BAN
SPRINGER & PERRY
Suite 2300
301 Fifth Avenue Building
Pittsburgh, Pennsylvania 15222
412-566-1351

*Counsel for Respondent*

Date: January 4, 1980

SMITH BROS., LAW PRINTERS, 620 SECOND AVENUE, PITTSBURGH, PA. 15219

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## BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

Respondent respectfully submits that a Writ Of Certiorari should not issue to review the Judgment Order of the United States Court of Appeals for the Third Circuit entered September 10, 1979.

## OPINIONS BELOW

Respondent concurs in Petitioners' statement of the opinions below.

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## JURISDICTION

Respondent does not question the jurisdiction as set forth in the Petition.

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## QUESTION PRESENTED

Does the federal statute and public policy pertaining to grants awarded to hospitals to fund staff costs at community mental health centers prohibit the deduction of such grants by a non-profit hospital plan in determining reimbursable costs (i) where the federal statute does not expressly prohibit such deduction, (ii) where the federal regulations defining compliance with the applicable provision of the federal statute were strictly complied with, and (iii) where, under the reimbursement formula in use, the non-profit hospital plan in fact subsidizes the mental health services for which the grants were made?

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## STATUTE AND REGULATIONS INVOLVED

Respondent does not question the statement of the statute involved as set forth in the Petition. However, it is important to note that certain federal regulations, 42 C.F.R. paragraphs 54.302(c); 54.302(d)(2)(iv); 54.305(b) and 54.306 set forth in Appendix G, *infra,* p. 1a, expressly state the test to be employed in determining compliance with the provision of the statute which is centrally at issue herein.

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## STATEMENT OF THE CASE

### History of the Proceedings

The instant action is before this Court on Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit by nine Plaintiff-Petitioners, all non-profit hospitals in Western Pennsylvania (the "Hospitals" or "Petitioner Hospitals").[1] The Hospitals originally brought suit against Respondent, Blue Cross of Western Pennsylvania, also a non-profit corporation ("Blue Cross"), in the Court of Common Pleas of Westmoreland County, Pennsylvania.

The Hospitals' Complaint sought to enjoin Blue Cross from computing reimbursable costs to the Hospitals in the manner then and now employed by Blue Cross and also sought money damages from Blue Cross

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1. The Hospitals are Westmoreland Hospital Association; Latrobe Area Hospital; The Altoona Hospital; The Hamot Medical Center of Erie, Pennsylvania; Meadville City Hospital; Saint Vincent Health Center; Community Mental Health Center of Beaver County; South Hills Health System; and Henry Clay Frick Community Hospital, all non-profit corporations.

upon the grounds that Blue Cross' deduction of certain federal grants received by the Hospitals in determining reimbursable costs violated the reimbursement contract between the Hospitals and Blue Cross and was contrary to federal law, including directives of the Department of Health, Education and Welfare.

The federal grants at issue (the "Federal Staffing Grants") are funds provided by the federal government "to meet . . . a portion of the costs . . . of professional and technical personnel for the initial operation of new community mental health centers or of new services in community mental health centers." 42 U.S. Section 2688(a). Each Petitioner Hospital received Federal Staffing Grants pursuant to the Community Mental Health Centers Construction Act Amendments of 1965, P.L. 89-105, August 4, 1965, 79 Stat. 427, 42 U.S.C. Section 2688, et seq., as amended by P.L. 90-31, June 24, 1967, 81 Stat. 79; P.L. 91-211, March 13, 1970, 84 Stat. 55; P.L. 91-515, October 30, 1970, 84 Stat. 1297; and P.L. 94-63, July 29, 1975, 89 Stat. 309, 42 U.S.C. Section 2689 et seq. (collectively referred to herein as the "Federal Statute").

The instant action was precipitated when the Department of Health, Education and Welfare ("HEW") notified the Hospitals that they were in violation of a condition attached to the Federal Staffing Grants and that the grants would be discontinued on January 1, 1977 unless the Hospitals persuaded Blue Cross to cease deducting the Federal Staffing Grants in determining allowable costs for Blue Cross reimbursement purposes.

Blue Cross removed the suit, pursuant to 28 U.S.C. Section 1441, et seq., to the United States District Court for the Western District of Pennsylvania upon the



grounds that the Hospitals' Complaint set forth civil causes of action arising under the Federal Statute. The Hospitals filed a Motion to Remand the action to the State Court. The district court denied the Hospitals' Motion to Remand and joined the Secretary of HEW as an indispensable party under Rule 19 of the Federal Rules of Civil Procedure. Subsequently, HEW counterclaimed against eight of the Hospitals seeking to recover for allegedly erroneous grant payments made since the 1975 amendments to the Federal Statute, alleging that the Hospitals had violated an assurance which they were required to make to HEW that the Federal Staffing Grants would be used to supplement state, local and other non-Federal funds and in no event supplant such funds.

A non-jury trial was held beginning on June 15, 1977 and concluding on August 16, 1977. The district court rendered an Opinion and Order on August 14, 1978, which found that Blue Cross properly deducted the Federal Staffing Grants under its contracts with the Hospitals, that Blue Cross' deduction did not violate the Federal Statute or any underlying public policy, and that the Hospitals had not violated their assurances to HEW in receiving the grants. The district court concluded that Blue Cross owed nothing to the Hospitals, that the Hospitals owed nothing to HEW and that HEW should continue to make the Federal Staffing Grants.

The Hospitals and HEW appealed to the United States Court of Appeals for the Third Circuit from the district court's decision. Thereafter, HEW dismissed its appeal. The Court of Appeals concluded that federal jurisdiction was proper and affirmed the judgment of the district court on the merits stating that it had "no

difficulty affirming the judgment of the district court essentially for the reasons set forth in its opinion." (App. D, p. 16a) (Appendix references set forth herein are to the appendices set forth in the Petition for a Writ of Certiorari).

**History of Blue Cross Reimbursement of Hospitals**

Blue Cross, which came into existence in 1938 as a non-profit corporation, developed in the ensuing years a comprehensive program of pre-paid hospital services and made such services available to the entire Western Pennsylvania community. One of the most important developments of the Blue Cross program is its Participating Hospital Reimbursement Agreement (the "Reimbursement Agreement") under which Blue Cross pays area hospitals directly for services rendered to hospital patients who are Blue Cross subscribers. This new method of payment greatly improved the hospitals' financial positions by providing them with a reliable and regular source of payments for patient services. In addition, Blue Cross offers comprehensive coverage for all segments of the community, including higher risk subscribers, which coverage substantially reduces a participating hospital's bad debt loss. The participating hospitals,[2] including all nine Petitioner Hospitals, in return for these and other benefits agreed to charge Blue Cross their costs attributable to rendering services to Blue Cross subscriber patients rather than charging Blue Cross the hospital's retail charges.

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2. Participating hospitals are defined by the Hospital Reimbursement Agreement as parties thereto. There are over 100 participating hospitals in Western Pennsylvania.



Until 1966, when the Federal Medicare program was enacted and placed in operation, the Blue Cross determination of the amount to be paid to a participating hospital under the Reimbursement Agreement then in effect was based upon a determination of average per diem costs of the participating hospital. However, in 1966 when the Medicare program took effect, Medicare's system of reimbursement for services received by Medicare recipients resulted in hospitals being paid by Medicare an amount which was approximately 4% less than their average costs for services. Responding to the financial dilemma of the participating hospitals created by the Medicare reimbursement gap, Blue Cross in its 1966 Reimbursement Agreement adopted a unique method of reimbursement whereby Blue Cross pays participating hospitals about 4% above their average cost for services provided all Blue Cross patients, thus alleviating the reimbursement gap left by the Medicare system. (App. F, p. 27a, 31a)

The Blue Cross reimbursement formula which has been in effect since the advent of Medicare in 1966 is known as the RCCAC formula (Ratio of Charges-to-Charges Applied to Costs). Under this formula, after Medicare costs have been carved out, the remaining hospital costs are apportioned between inpatient and outpatient costs in the same proportion that the hospital's charges are divided between inpatient and outpatient charges. As the district court found, under the RCCAC formula any reduction in outpatient charges below cost operates to increase inpatient per diem costs and thereby increases Blue Cross' total reimbursement to a participating hospital because of the preponderance of Blue Cross covered inpatient services. As hereinafter discussed, as a result of the Petitioner Hospitals' practices of charging far less than their costs for outpatient men-

tal health services, Blue Cross' total reimbursement to each Petitioner Hospital has greatly increased. In addition, because the Federal Staffing Grants were restricted to new or expanded mental health services, Blue Cross' level of payments to the Petitioner Hospitals significantly increased as a result of their receipt of the Federal Staffing Grants because it was reimbursing costs of new services which had not been incurred before (App. F, p. 34a, 37a).

Irrespective of what formula is used to reimburse hospitals, before applying the formula, Blue Cross must first determine a hospital's costs. This initial cost determination was centrally at issue in this action.

Since 1951, the reimbursable costs of a participating hospital have been established by uniformly applying cost accounting principles developed by Blue Cross in conjunction with and in constant communication with the participating hospitals. One such accounting practice has been the distinguishing between, and treating differently, types of gifts and grants a hospital receives. As a result, gifts, grants and endowments to hospitals have become classified as either "restricted" or "unrestricted". Throughout the entire course of their cost reimbursement history, a restricted gift or grant has been defined and classified by Blue Cross and by the participating hospitals as a gift, grant and/or income from endowments, the proceeds of which must be used only for a specific purpose designated by the donor thereof.[3]

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3. The deduction of restricted grants in determining cost reimbursement is consistent with generally accepted accounting principles and has been endorsed by the American Hospital Association, the Commonwealth of Pennsylvania for Medicaid purposes and by HEW for Medicare purposes. (App. F, p. 28a).



Restricted grants and gifts have been consistently deducted from the amount of a participating hospital's costs in determining such hospital's "allowable costs" for Blue Cross reimbursement purposes.[4] The rationale for deducting a restricted grant from costs is to maintain a principle of reimbursement basic to the community and to the Reimbursement Agreement that a hospital should only be reimbursed for its reasonable costs, and that if a specific item of cost has already been paid for it should not again be the basis for reimbursement.

When the Hospitals began receiving the Federal Staffing Grants, Blue Cross deducted the amount of the grants from each Hospital's costs as a restricted grant pursuant to the Reimbursement Agreement, because the Federal Staffing Grant was specifically limited by the terms of the Federal Statute to be used only to pay staff salaries in a Hospital's community mental health center.[5]

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4. Blue Cross' 1973 Reimbursement Agreement, currently in effect, provides that the reimbursement formula is applied to a hospital's "allowable costs".

5. The district court found that the practice of deducting restricted grants in determining reimbursable costs was an operative term under the applicable Reimbursement Agreements even though the Reimbursement Agreements do not mention restricted grants as such (App. F, p. 26a). See *United Mercury Mines Co. v. Bradley Mining Co.*, 259 F.2d 845 (9th Cir. 1958); *Edward E. Morgan Co. v. United States*, 230 F.2d 896 (5th Cir. 1956); *Pacific Grape Prod. Co. v. Commissioner of Internal Revenue*, 219 F.2d 862 (9th Cir. 1955); *Wilson v. Homestead Valve Mfgr. Co.*, 217 F.2d 792 (3d Cir. 1954); *John I. Haas, Inc. v. Wellman*, 186 F.2d 862 (9th Cir. 1951); *Tennessee Gas & Transmission Co. v. El Paso Natural Gas Co.*, 166 F.2d 9 (5th Cir. 1948); *McKeefrey v. Connellsville Coke & Iron Co.*, 56 F. 212 (3d Cir. 1893); *Electric Reduction Co. v. Colonial Steel Co.*, 276 Pa. 181 (1923); *Fiske v. First Nat. Bank of Butte,*

**History of the Federal Staffing Grants**

The relevant history of the Federal Statute authorizing the Federal Staffing Grants commenced in 1963 when Congress enacted P.L. 88-164 entitled the "Mental Retardation Facilities and Community Mental Health Centers Construction Act of 1963", 42 U.S.C. Section 2661 et seq., which provided funds for new building facilities if states developed comprehensive mental health plans which would make mental health care available in local communities. In 1965, Congress enacted P.L. 89-105 entitled the "Community Mental Health Centers Construction Act Amendments" which authorized the Secretary of HEW to make:

> "grants to meet, for the temporary periods specified in this Section, a portion of the costs (determined pursuant to regulations under Section 2688c of this title) of compensation of professional and technical personnel for the initial operation of new community mental health centers or of new services in community mental health centers." 42 U.S.C. Section 2688(a).

Such Federal Staffing Grants were authorized on a decreasing matching basis to finance a portion of the eligible staffing costs of a community mental health center ("CMHC"). There is no question that the object of the Federal Statute was to sponsor a system of local mental health facilities to provide certain "essential" mental health services, specified in the Federal Statute,

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133 Pa. 241 (1890); *Adams v. Pittsburgh Ins. Co.*, 95 Pa. 348 (1880); *Carter v. Philadelphia Coal Co.*, 77 Pa. 286 (1875); *Fischer v. Congregation B'Nai Yitzhok*, 177 Pa. Super. 359 (1955); *Stenden v. Twin City Foods, Inc.*, 510 P.2d 221 (Wash. 1973); *Restatement of Contracts*, Section 247.



on a community basis to generally replace "the outmoded type of institutional care which now prevails".[6] However, as admitted by HEW in the case at bar, "nothing is contained in the federal statute which would indicate that it is intended to control the activities of this Blue Cross plan or any other third-party payor in applying a reimbursement formula." (App. F., p. 31a).

Centrally at issue in the instant action is the provision of the Federal Statute (the "supplement not supplant" provision) which required the Hospitals, as potential Federal Staffing Grant recipients, to give assurance to HEW that the Federal Staffing Grants would not supplant "State, local and other non-Federal funds". P.L. 89-105, Section 221(a)(4), 42 U.S.C. Section 2688a(a)(4).[7] The sanction set forth in the Federal Statute for a CMHC's failure to comply with such assurance was the loss of the Federal Staffing Grant. There is no mention of the invalidation of reimburse-

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6. [1963] U.S. Code Cong. & Ad. News, p. 1469.

7. Under the 1975 amendments to the Federal Statute, Section 206 (c) (2) (B) (ii) of P.L. 94-63, 42 U.S.C. Section 2689e, the Secretary of HEW could approve an application for a grant only if he determines that the application contains or is supported by satisfactory assurances that federal funds made available thereunder will "be used to supplement and, to the extent practical, increase the level of State, local and other non-Federal funds, including third-party health insurance payments, that would in the absence of such Federal funds be made available for the applicants' comprehensive mental health services and (II) in no event supplant such State, local and other non-Federal funds." The language of 42 U.S.C. Section 2689e is substantially the same as 42 U.S.C. Section 2688a which was in effect prior to the 1975 amendments.

ment agreements with third party payors such as Blue Cross.

The Hospitals applied for and received Federal Staffing Grants at various times since 1969. In all relevant grant years each Hospital gave such assurance to HEW. During such period, because the Federal Staffing Grants fit exactly within the definition of a restricted grant under the Reimbursement Agreement, Blue Cross consistently treated the Federal Staffing Grants as a deduction from costs in determining the Hospitals' reimbursable Blue Cross costs.

The district court's decision that Blue Cross' deduction of the Federal Staffing Grants in determining the Hospitals' reimbursable costs (i) is not illegal or opposed to public policy (App. F., p. 33a), and (ii) has not caused the Hospitals to violate the "supplement not supplant" assurance (App. F., p. 41a) was based in part on its finding that each Hospital had complied with a "Maintenance of Effort" test set forth in the Federal Regulations.

42 C.F.R. paragraph 54.302(c) adopted on March 1, 1966, and still in effect, provides that compliance with a "Maintenance of Effort" test "shall be deemed to constitute" a satisfactory assurance that the "supplement not supplant" provision of the Federal Statute has not been violated. 42 C.F.R. paragraph 54.302(c) states:

> "For purposes of section 221(a)(4) of the Act, with respect to assurance that Federal funds will not supplant non-Federal funds, budget information meeting the requirements of Section 54.305(b) sufficient to support a grant under Section 54.306, together with information providing an adequate basis for a determination by the Surgeon General under paragraph (d)(2)(iv) of this section that there has not been a decline in State financial support, shall be deemed to constitute such satisfactory assurance . . . ."



The test referred to in 42 C.F.R. paragraph 54.302 (c) is that budget information must be supplied showing (i) that in the year for which a Federal Staffing Grant is requested, the CMHC's total expenditures for mental health services will exceed its average expenditures therefor during the two-year period preceding the CMHC's initial receipt of a Federal Staffing Grant, 42 C.F.R. paragraphs 54.305(b) and 54.306, and (ii) that the amount expended by the state for mental health purposes in such calendar year will not decline from the amount expended by the state therefor in either of the two preceding calendar years, 42 C.F.R. paragraph 54.302(d)(2)(iv).

Not only do the Federal Regulations set forth the sole test for compliance with the "supplement not supplant" provision of the Federal Statute, the CMHC instructional materials and budget information compliance forms distributed by HEW also state that the "Maintenance of Effort" test determines compliance with "supplement not supplant" provision of the Federal Statute.

HEW was on notice that Blue Cross was deducting the Federal Staffing Grant as early as 1969, but did not act to cancel the grants until late in 1976. (App. F, p. 27a). Medicare, which has a different cost reimbursement system than Blue Cross', deducted the Federal Staffing Grants as restricted grants for approximately

six years until a "seed money" exception was added to the Medicare reimbursement practices in 1971.[8]

In 1969, when HEW was notified that the State of Pennsylvania deducted the Federal Staffing Grants in determining allowable costs for mental health reimbursement purposes, HEW responded as follows:

> The matter of how the state views the federal matching money (as part of the 90% eligible for their participation or otherwise) is entirely up to them .... We are quite aware that the staffing grant, during the four years of its existence in a sense replaces state money, but more to the point it provides the means to share the financial burden for the initial period so the state has lead time for planning and getting ready to assume the full cost of services." (Defendant's Exhibit C).

In response to an interrogatory propounded by Blue Cross to HEW as to why it continued to make the Federal Staffing Grants in Michigan for a number of years after learning that the grants were being deducted by Blue Cross of Michigan in determining reimbursable costs, HEW stated that the Secretary was awaiting "the ascertaining of a national policy by the National Institute of Mental Health on such matter" (App. F., p. 33a).

The district court therefore found "the Secretary [of HEW], until this litigation, has never had a policy on this issue and has never contended that deduction of the

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8. Blue Cross is in no way obligated to follow the Medicare reimbursement system in computing Blue Cross' reimbursement. (App. F., p. 30a).



grants is opposed to the law or public policy." (App. F., p. 33a)

As set forth hereinabove, under Blue Cross, reimbursement formula, a reduction in a hospital's outpatient charges below cost operates to increase the hospital's inpatient costs and thereby increases Blue Cross' total re mbursement to the hospital because of the preponderance of Blue Cross covered inpatient services. The evidence of record in the instant action shows that each Hospital's outpatient mental health costs substantially exceeded its outpatient mental health charges (App. F., p. 36a-38a). Because the CMHC services were required by the Federal Statute to be new services and caused each Hospital to incur additional costs, and since the effect of the Hospitals' practice of undercharging for outpatient mental health services grossly inflated Blue Cross' reimbursements to the Hospitals, the district court concluded that Blue Cross has in fact been subsidizing the Hospitals' mental health programs even though it deducts the Federal Staffing Grants in determining Blue Cross reimbursement. (App. F., p. 34a, 37a).

In summary (i) the Federal Statute does not purport to control the reimbursement practices of a third party payor such as Blue Cross or in any way prohibit the deduction of the Federal Staffing Grants in computing cost reimbursement; (ii) the Federal Regulations and HEW's instructional materials expressly set forth the sole test for determining compliance with the "supplement not supplant" provision of the Federal Statute; (iii) each Petitioner Hospital complied with such test even though Blue Cross deducted the Federal Staffing Grants in computing Blue Cross' reimbursement; and

(iv) under Blue Cross' reimbursement formula, the Hospitals' practice of charging below cost for outpatient mental health services has caused Blue Cross to subsidize the Hospitals' mental health programs even though Blue Cross deducted the Federal Staffing Grants in determining reimbursable costs.

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## REASONS FOR DENYING THE WRIT

1. The Petitioner Hospitals argue in each point of their "Reasons For Granting the Writ" that Blue Cross' deduction of the Federal Staffing Grant in determining cost reimbursement contravenes both the "supplement not supplant" provision of the Federal Statute and the public policy underlying the Federal Statute, and assert that such deduction has harmed the Hospitals and the public because the effect thereof is that the Hospitals receive less Blue Cross reimbursements than they would have if the Federal Staffing Grant were not deducted. However, there is no foundation in the record for such argument because the district court found that the Hospitals failed to sustain their burden of proof that Blue Cross' deduction results in the supplanting of private funds by the Federal Staffing Grant.[9] This finding of fact has not been challenged by the Hospitals.

It is submitted that the district court carefully scrutinized the effect of Blue Cross' deduction of the Federal Staffing Grants and the overall effect of Blue Cross' Reimbursement Agreement on reimbursements to each of the Hospitals and properly determined that no supplanation has occurred and that no harm has resulted to the Hospitals' mental health programs as a result thereof. To the contrary, the district court found that under Blue Cross' reimbursement formula the fact that the Hospitals' outpatient mental health costs far exceeded the Hospitals' charges for outpatient mental health services resulted in Blue Cross "subsidizing the

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9. "I am not convinced by a preponderance of the evidence that there has been any supplanting of private money by the federal grants as a matter of fact." (App. F., p. 38)

Mental Health Programs to a large extent" (App. F., p. 37a).

Since the district court refused to find as a matter of fact that Blue Cross' deduction of the Federal Staffing Grants results in supplantation or in any lessening of Blue Cross' obligations to the Hospitals, there is simply no factual basis in the instant action to support the Hospitals' argument that the public policy underlying the Federal Statute has been violated by virtue of Blue Cross receiving a "substantial benefit from the grant money to the detriment of the mental health program."[10] Because the Hospitals' "Reasons for Granting the Writ" necessarily depend upon a factual determination which the district court refused to make, the hospitals' Petition for a Writ of Certiorari should be denied. This Court does not grant a certiorari to review evidence and discuss specific facts, *United States v. Johnston,* 268 U.S. 220, at 227 (1925).

2. Although the instant case is one of first impression insofar as the Federal Statute is concerned, the consequences hereof are hardly "far flung" as contended by the Hospitals. Apparently HEW does not believe that the consequences of the district court's decision are "far flung" because HEW has not appealed from the denial of its counterclaim herein.

The district court carefully scrutinized the overall effect of Blue Cross' reimbursement formula on each Hospital, including the deduction of the Federal Staffing Grants, and found that Blue Cross' reimbursement con-

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10. On the merits the Third Circuit Court of Appeals had "no difficulty affirming the judgment of the district court essentially for the reasons set forth in its opinion. . . ." (App. D., p. 16a)



tract is unique (App. F, p. 27a) and that as a result of Blue Cross' unique contract "Blue Cross subscribers have been subsidizing a good portion of the costs of the mental health programs thus far". (App. F, p. 34a) Necessarily, the applicability of the decision on the merits of the instant case to other Blue Cross plans and other CHMCs is dependent on whether the factual situation presented would be similar to that in this case in regard to, inter alia, the ability of the Hospitals to unilaterally increase their Blue Cross reimbursements by undercharging for outpatient mental health services.

Even if a similar factual and contract setting were presented in a reimbursement dispute between a CMHC and a third party payor, the district court's decision herein would not have an adverse impact upon the CMHC or the patients it serves because the district court correctly concluded that Blue Cross' deduction of the Federal Staffing Grant does not result in supplantation and is permissable under the Reimbursement Agreement.

3. It is respectfully submitted that the instant action presents neither (i) a situation where a lower court has decided a federal question in a way in conflict with the applicable decisions of this Court, nor (ii) an important federal question which has not been, but should be, settled by this Court. The district court properly concluded that neither the Federal Statute, the regulations promulgated thereunder nor any underlying public policy renders Blue Cross' reimbursement practice void.

The "supplement not supplant" provision of the Federal Statute, as admitted by HEW, does not control the reimbursement practices of a third party payor such as Blue Cross (App. F., p. 31a), but is an assur-

ance which CMHCs must give to HEW to qualify for the Federal Staffing Grants. The sanction set forth in the Federal Statute for a CMHC's non-compliance with such assurance is the loss of the Federal Staffing Grant, not the invalidation of reimbursement agreements with third party payors.

Furthermore, the regulations promulgated by HEW expressly set forth a test, referred to as a "Maintenance of Effort" test, for determining compliance with the "supplement not supplant" provisions. The regulations provide that a CMHC has complied with its assurance if it shows that (i) in the fiscal year when the Federal Staffing Grant is received the CMHC's total expenditures for mental health services exceeds its average expenditures therefor during the two-year period preceding its initial grant period; and (ii) the amount expended by the State for mental health services during such year will not decline from the amount expended in either of the two preceding years. 42 C.F.R. paragraphs 54.302(c); 54.302(d)(2)(iv); 54.305(b); 54.306.[11]

There is no dispute that each Hospital complied with the "Maintenance of Effort" test for all relevant grant years. Clearly the "Maintenance of Effort" test

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11. Congress endorsed a "Maintenance of Effort" test for determining compliance with the "supplement not supplant" provision of the Federal Statute, when it enacted an amendment to the Federal Statute on October 30, 1970, P.L. 91-515, Title III, Section 301, which amendment provided that for CMHCs which received a Federal Staffing Grant before June 30, 1970, the "supplement not supplant" assurance "shall be deemed to have been complied with" for any period after June 30, 1970 if the CMHC's total mental health staff costs are not less than its costs for the grant period which last commenced on or before June 30, 1970.



has no bearing whatsoever on Blue Cross' reimbursement formula. It is important to note that the Hospitals have not appealed the district court's finding that the "supplement not supplant" provision of the Federal Statute has not been violated by virtue of the Hospitals complying with the "Maintenance of Effort" test.

The district court did not restrict its public policy analysis to just the Federal Statute and applicable regulations. The district court analyzed CMHC instruction manuals and CMHC report of expenditure forms distributed by HEW, all of which state that compliance with the "Maintenance of Effort" test constitutes compliance with the "supplement not supplant" requirement. Moreover, the district court properly found that "the Secretary [of HEW], until this litigation, has never had a policy on this issue and has never contended that deduction of the grants is opposed to the law or public policy" (App. F., p. 33a). Such finding was based in part upon the fact, noted above, that HEW, in response to an interrogatory concerning the reason it continued to make the Federal Staffing Grants when it was aware of the deduction thereof for cost reimbursement purposes, stated that it did so because the Secretary of HEW was awaiting "the ascertaining of a national policy by the National Institute of Mental Health on such matter." (App. F., p. 33a).

Since neither the Federal Statute, the regulations promulgated thereunder, nor any of HEW's CMHC forms make any mention of the deduction of the Federal Staffing Grants for cost reimbursement purposes, this Court's decision in *Muschany v. United States,* 324 U.S. 49 (1945) directly supports the district court's decision that Blue Cross' reimbursement practice violates neither

the Federal Statute nor the public policy underlying the Federal Statute. As this Court stated in *Muschany* at 66:

> "As the term 'public policy' is vague, there must be found definite indications in the law of the sovereignty to justify the invalidation of a contract as contrary to that policy. . . . Only dominant public policy would justify such action. In the absence of a plain indication of that policy through long governmental practice or statutory enactments, or of violations of obvious ethical or moral standards, this Court should not assume to declare contracts . . . contrary to public policy." (citation omitted)

This Court's decision in *Steele v. Drummond,* 275 U.S. 199 (1927), relied upon by the Hospitals in their "Reasons for Granting the Writ", did not deal with the issue of whether a contract is void as contrary to "public policy" as established by a legislative enactment. However, this Court clearly recognized in *Steele v. Drummond* that, with respect to invalidating contracts as being contrary to public policy,

> "It is a matter of great public concern that freedom of contract be not lightly interfered with. . . . It is only in clear cases that contracts will be held void." 275 U.S. at 205.

The Hospitals' Petition for a Writ of Certiorari does not mention the aforesaid Federal Regulations, HEW's CMHC instruction materials, or the 1970 amendment to the Federal Statute, all of which expressly state that the "supplement not supplant" requirement is met if a "Maintenance of Effort" test has been satisfied. Instead, the Hospitals argue that vague, general expressions of the purpose of the Federal Statute, which do not



deal with third party payor *cost* reimbursement at all and which are not contained in the Federal Statute, should have been relied upon to invalidate Blue Cross' reimbursement practice. Thus, the Hospitals' public policy argument violates the rule established by this Court in *Muschany v. United States, supra,* at 66, that "Public Policy is to be ascertained by reference to the laws and legal precedents and not from general considerations of supposed public interests."

Because the district court followed the directions of this Court in *Muschany v. United States, supra,* in concluding that Blue Cross' deduction of the Federal Staffing Grant does not violate the Federal Statute or the public policy underlying the Federal Statute, and because this Court's opinion in *Muschany* controls the issue of when a contract will be held invalid as contrary to public policy as established by a Congressional enactment, the instant action presents neither (i) a situation where a lower court has decided a federal question in a way in conflict with the applicable decisions of this Court, nor (ii) an important federal question which has not been, but should be, settled by this Court.

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*Conclusion.*

## CONCLUSION

For the foregoing reasons it is respectfully requested that the Petitioner Hospitals' Petition for a Writ of Certiorari be denied.

Respectfully submitted,

EDWARD L. SPRINGER, ESQ.
JOSEPH FRIEDMAN, ESQ.
STEPHEN F. BAN, ESQ.
SPRINGER & PERRY
Suite 2300
301 Fifth Avenue Building
Pittsburgh, Pennsylvania 15222
412-566-1351

*Counsel for Respondent*

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## APPENDIX G

### 42 Code of Federal Regulations

(as of October 1, 1975)

SUBPART D—GRANTS FOR INITIAL COST OF PROFESSIONAL AND TECHNICAL PERSONNEL OF COMMUNITY MENTAL HEALTH CENTERS

PARAGRAPH 54.302. ELIGIBLE CENTERS.

To be eligible for a grant to assist in the initial operation of a community mental health center under Part B of Title II of the Act the application must be in accordance with, and set forth the assurances and information required by, Section 221(a) of the Act and Section 54.305.

. . . .

(c) For purposes of section 221(a)(4) of the Act, with respect to assurance that Federal funds will not supplant non-Federal funds, budget information meeting the requirements of Section 54.305(b) sufficient to support a grant under Section 54.306, together with information providing an adequate basis for a determination by the Surgeon General under paragraph (d)(2)(iv) of this section that there has not been a decline in State financial support, shall be deemed to constitute such satisfactory assurance; Provided, That in determining whether there has been a decline in the proportion of public funds of the State in relation to the total funds expended in the State for mental health services as provided in paragraph (d)(2)(iv) of this section, the Surgeon General may, if he finds in a particular case that such action is consistent with section 221(a)(4) of the Act, disregard funds from private sources.

(d) In addition to describing the services to be provided by the center in the State mental health plan in

accordance with section 221(a)(5) of the Act the State mental health authority shall submit to the Surgeon General:

. . . .

(2) Such additional information as the Surgeon General may require in order to show: (i) Prospective developments in mental health manpower resources throughout the State, (ii) current and proposed efforts to meet statewide needs for such resources, (iii) a ranking of the areas of the State (according to the same geographical division as under Section 54.204 of Subpart C of this part) in order of their ability to meet their need for such manpower, (iv) the amount of funds derived from public revenues of the State expended or estimated to be expended during the current calendar year and the 2 preceding calendar years to provide public and private nonprofit mental health services for the population of the State, sufficiently documented to enable the Surgeon General to determine that the amount expended or estimated to be expended by the State for such purposes during such current year has not declined or will not decline either on a per capita basis or in proportion to the total amount expended in the State for such services from all sources, from the amount expended in either of such 2 preceding years.

PARAGRAPH 54.305. SUBMITTAL OF APPLICATION.

Each application for assistance under Part B of Title II of the Act shall be submitted to the Surgeon General, and a copy of such application shall be submitted to the mental health authority of the applicant's State responsible for submittal of plans in accordance with Title III of the Public Health Service Act, as



amended. Such application shall, in addition to any other information or assurances found necessary by the Surgeon General to act on the application, set forth the program for all community mental health services provided by the applicant or those affiliated with the applicant, including specific and detailed information and adequate assurances as to the following in such detail and in such form as may be prescribed by the Surgeon General:

. . . .

(b) *Budget.* (1) A statement for each of the two 12-month periods preceding the period for which an initial grant is requested, and an estimate for each period for which a grant is requested, of costs and income incurred or to be incurred by the applicant, affiliates and predecessors of the applicant with respect to all services included in the program set forth under paragraph (a) of this section; . . . .

PARAGRAPH 54.306. APPROVAL OF APPLICATION.

The Surgeon General may approve an application for Federal participation up to the maximum percentage (specified in section 220(b) of Title II of the Act) of eligible costs in excess of the average amount determined or estimated in such application to have been expended for mental health services by the applicant, affiliates, and predecessors of the applicant in the 2 years preceding the initial grant period for which application is made, where such application meets the eligibility requirements specified in Sections 54.302 and 54.303 and the allocation and priority requirements of Section 54.304.

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